The Inheritance Tax

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THE expenditures of all political bodies have been continually increasing. In normal times, the public has kept demanding that its governmental units undertake new and expensive functions, the cost of which has not always been considered. Some of the ordinary costly functions of modern governmental units are the establishment and maintenance of educational systems; the provision for defectives, delinquents and dependents; the protection to person, property and health; the building and maintenance of highways; and the regulation of railroads and public utilities, as well as numerous other forms of regulation. When an emergency arises, such as the Great War, expenditures, especially those of federal governments, mount to almost unbelievable heights.

All these increased expenditures must be met by increased revenues. So long as wealth and population increased more rapidly than the demand for additional funds, the individual burden was not increasing and, consequently, little interest was shown in the expenditures and revenues of political bodies. As the new burdens became more noticeable, citizens became concerned about the use to which funds were put, and about the justice of the methods by which they were secured. This has led fiscal officials, in their search for additional revenues, to use sources which will not only be productive of funds, but which can be upheld under the principles of justice, and which will cause a minimum of opposition from the public. The inheritance tax has been one source of revenue, the use of which has been greatly extended under these conditions, and which is likely to be extended much further in the future.

INHERITANCE TAX NOT OF RECENT ORIGIN

Most of the discussion of the inheritance tax has come in comparatively recent years, and to the uninformed this form of tax appears as a modern development in fiscal policies. It is an error, however, to consider the taxation of inheritance as being exclusively a modern fiscal device. As a matter of fact, some form of levy upon the transfer of property at death, dates back as far as authentic records can be obtained. Some traces of the use of this principle can be found as early as 2000 B.C. It appears that a well-defined system of levies on property successions existed in Egypt for a number of years before the Christian era. The emperor Augustus, moreover, used a tax on property transfers shortly after the birth of Christ. He desired to provide a fund for the pensioning of old soldiers, and proposed a tax of one-twentieth upon inheritances, to which the Senate consented only after he threatened to use a direct land tax. No distinction was made between bequests to relatives and to strangers, and only a low exemption was allowed. Some of the later rulers alleviated the stringency of the law to some extent by the recognition of family ties and dependency, consequently exempting some of the more direct bequests, such as between mother, father and children. Still later, these exemptions were removed and the law was made even more stringent than it had been at first, although it was again modified

before the tax was given up, probably about the beginning of the fourth century.

A semblance of the modern inheritance tax is found in the system of *reliefs* which existed in the Middle Ages. At the death of a tenant, the right of the tenancy to pass to his heir was recognized, yet some exaction was made by the landlord. So long as the amount could be voluntarily determined by the landlord, extortionate demands were often made, which practice led to the establishment of uniform rates by legislation. These duties, as well as another class of duties which were levied upon the transfer of property other than land, were found in a number of countries. They, of course, expired with the breakdown of the feudal régime. Sporadic attempts were made, however, to use some form of succession levy, especially in the countries on the continent, down to the formulation of permanent inheritance tax laws.

In their discussions of ways and means for raising revenues, the early writers upon fiscal subjects generally gave space to a consideration of inheritance taxes. Adam Smith opposed the principle because he thought it did not conform to his canons of taxation. He contended that it increased the transfer of capital, which was the basis of productive labor of individuals, to the use of the state, the most of whose activities are unproductive. He did admit, however, that when the property descended to others than dependents, it might be taxed without a feeling of any very great inconvenience. Ricardo objected to the tax on the ground that it was a capital levy. His reasoning was that, if a man paid a tax of $100 out of a bequest of $1,000, he would have no inclination to save the amount of the tax, but would consider the bequest as one of $900. If, however, he were allowed the $1,000, and were then assessed the amount of the tax on some objects of consumption, he would retrench expenditures in order to save the necessary amount.

John Stuart Mill and Jeremy Bentham may be cited as examples of early writers who advocated the use of inheritance taxes in the extreme. Mill expressed the opinion that inheritances, other than to near relatives, should be abolished; that the amount which could be received by bequest should be strictly limited, and that rates should be progressive. He denied any right of inheritance, and contended that both individuals and society would be better off if no one were freed from the necessity of working by the receipt of a large fortune.

Bentham favored the inheritance tax because he thought it would produce revenue with the minimum of sacrifice. He expressed his position in the form of a paradoxical question: "What is that mode of supply, of which the twentieth part is a tax, while the whole would be no tax and would not be felt by anybody?" He contended that his position would be accomplished if the power of bequest of persons having no direct heirs were regulated, and that all cases of intestacy—descent of property when no will had been made—be abolished, except among near relatives. A person who had expected no inheritance would feel no burden if the state took the entire amount. If, however, an estate had been given to him, and then a part taken for taxes, the burden at once would be apparent.

These views of Smith, Ricardo, Mill and Bentham are but representative of many which were expressed by early writers upon economic topics. It is readily seen, moreover, that inheritance taxes are not the product of

modern minds, but that they have had a long course of development.

MANY CLASSES ADVOCATE TAX

It is not necessary to turn to earlier years to find those who advocate the use of the inheritance tax. Much of the earlier opposition has broken down, and ardent supporters of the principle may be found among all classes, among those interested in social as well as fiscal reform, and among the rich as well as among the poor. Because it can be used to encourage a social equality and as a means for a fairer distribution of tax burdens, it has found its most extensive development in the more democratic countries, such as Great Britain, Switzerland and the United States.

It is but natural that individuals who are socialistically inclined should be strong supporters of the inheritance tax, for it can easily be used as a method for the reduction of large fortunes. Those who are concerned with securing a more equitable distribution of the tax burden on the basis of ability to pay, and who are only secondarily interested in the social consequences, have come to look upon the inheritance tax as a valuable addition to the fiscal system. Fiscal authorities, both federal and state, in the severe pressure for funds which has continually existed during recent years, have been glad to turn to this previously little used source of revenue to help replenish an empty treasury. Still others sanction the use of a severe taxation of inheritance, not primarily for an equalization of wealth *per se*, nor as a source of revenue, but because of the beneficial effects which a limitation of fortunes would have upon the recipients. As might be expected, labor organizations of various kinds have been enthusiastic supporters of the principle, as also have been the members of the more radical political parties. Theodore Roosevelt is an example of a national statesman and leader who thoroughly believed in the justice of taxing inheritances.

An interesting example of an advocate of the extreme use of inheritance taxes because of the expected beneficial results upon the recipient, was the late Andrew Carnegie. He held, in his numerous writings and speeches, that it was a mark of misguided affection for parents to leave great fortunes to their children, especially to sons. To do so deadens their talents and energies and results in a less useful life than would otherwise result. A man, he thought, should be prevented from handicapping his son by bestowing great wealth upon him. He believed, further, that the proper use of great riches is to benefit society from which they have been taken. If, then, men persist in amassing great fortunes without making a just social return, the state should make sure of its proper share by the use of an inheritance tax. He advocated a steeply progressive rate to as high as 50 per cent, and believed that a large part of the needed revenue could be secured from this source, with the feeling of very little burden.[1]

JUSTIFICATIONS FOR TAX

There is perhaps no part of any fiscal system which has had so many and diverse arguments advanced in its favor as a tax upon the transfer of property at death. These range all the way from arguments of a purely social nature to those justifying the principle as a part of the fiscal machinery. The social arguments, for the most part, look to the limitation of fortunes, and follow closely the ideas of Bentham and Carnegie.

[1] Mr. Carnegie's views on inheritances are elaborated in his book, *The Gospel of Wealth*.

One common justification for the inheritance tax is known as the extension of escheat. This is based upon the principle that there is no natural right of inheritance—that the state has gone a long way in allowing an individual to have control over property while alive, but would be going entirely too far to allow him to have control over it after death. The disposition of property after death, then, is really a state function, and it is a matter for the state to decide to what extent property shall be inherited. Under this theory there is little basis for the justification of collateral inheritance, while it becomes the duty of the state to determine to what extent and under what conditions direct inheritance shall be permitted.[2]

The argument which has branded the inheritance tax as "socialistic" has been what is usually known as the diffusion of wealth argument, that is, its use for the purpose of breaking up large fortunes to more nearly equalize the ownership of wealth. Many proposals have been made, and some laws have been enacted, with this purpose in mind. It has been proposed, for example, to fix a maximum amount beyond which inheritance would not be permitted. The steepness of the rate of progression in the laws which have been enacted reflects to some extent the limitation which was intended to be put upon inherited fortunes.

The use of the inheritance tax as a regulator of the size of inherited fortunes need not, however, be condemned as a socialistic proposal. It may be desirable to limit the amount of an inheritance for reasons other than the mere diffusion or equalization of wealth. If, as Mr. Carnegie contended, the moral, social and economic efficiency of the citizens of the state is impaired because of the succession of large fortunes, then it becomes the duty of the state to impose regulation. Inheritance taxes, from this viewpoint, would properly come under the jurisdiction of the police power when levied by the commonwealth. Since, moreover, the right of inheritance is not considered a natural right, but one granted by the state, any limitation which the state may see fit to impose must be considered justifiable and not an encroachment on the right of private property.

Some attempts have been made to justify the taxation of inheritances because of the benefits which the state gives in making the transfer of property, or has given in the accumulation of the property. The mere transmission of wealth at death inevitably places some burden upon the state with an accompanying expense. Court officials must be maintained for the purpose of making the transfer in a proper manner, and for guaranteeing the title to the property. While this service is maintained primarily for the benefit of the public, yet at the same time a special benefit is conferred for which it is perfectly proper to make some exaction. From the nature of the case, and in comparison with other similar court services, the payment required would be no more than the cost of rendering the service. This would be a fee payment and could scarcely be classed as a tax. The payment would necessarily be small, and there would be no place for progressive or even proportionate rates. A uniform charge for a bequest of any size would be the most logical, since the cost to the court would vary but

[2] By a collateral inheritance is meant the devolution of property to non-relatives or to distant relatives, as cousins, nephews and nieces. A direct inheritance refers to one in the immediate family, as between husband, wife, son or daughter, and sometimes between brother and sister.

little with the size of the estate. This principle is the chief consideration in the laws relating to inheritances in some of our states.

A more strict attempt to use benefit as the basis for the levy against the transfer of an estate is found when it is claimed that the state should exact an amount based upon the value of its service to the recipient of the transfer. This argument again goes back to the principle that there is no natural right to transfer property after death. The state, then, has conferred a benefit on the recipient by establishing the institution of inheritance and consequently making it possible for the transfer to take place. A valuable benefit has been conferred thereby, for which payment should be exacted. The state, furthermore, looks after the safe transfer of the property and places the title securely in the hands of the recipient which enhances the value of the benefit. The difficulty with this argument is the difficulty with the whole theory of benefit as a base for taxes. To measure accurately the value of the benefit in each particular case would be impossible, and the justice of the tax would therefore vary according to the accuracy of the measurement.

Still another application of the principle of benefit is found in the concept that the state has been a contributing factor in the accumulation of wealth, and at the death of the holder is entitled to its share, rather than have the whole pass to someone who was only remotely, or not at all, instrumental in the production of the wealth. Society, because of its contributions to the accumulation of fortunes, has a right to demand a return through a contribution to the government at the death of the holder. Here again the difficulty of accurate measurement presents itself. That society and governments are instruments which aid the accumulation of individual wealth are outstanding facts, and it is for such intangible and immeasurable benefits as this that general taxes are levied. The use of the principle of benefits in tax levies, because of the difficulties encountered, has all but been discarded.

CONFORMITY TO MODERN FISCAL CONCEPTS

A consideration of justice in taxation would reveal that, through a process of evolution, the most commonly accepted principle for the just levy of taxes is ability to pay, with perhaps some consideration for the utilitarian principle of the greatest good to the greatest number. To students of fiscal problems, at least, a study of the inheritance tax from this standpoint assumes a rôle of primary importance. Many arguments have been advanced to justify the use of the inheritance tax as a part of fiscal systems, some of which are worthy of review.

One of the earlier justifications for the inheritance tax was that it is but a collection of the taxes which were expected to be paid while the fortune was in the process of accumulation. This is commonly called the back tax argument. The reason has been effective, and not without foundation because of the widespread evasion of personal property taxes. This argument, in fact, has been used extensively in securing inheritance tax legislation. From the standpoint of pure justice, however, such reasoning can not stand. The evasion of taxes upon different accumulations of wealth has by no means been the same, and yet it is impossible to attempt any discriminations on the basis of the extent to which taxes have been evaded. In this respect, the inheritance tax falls alike upon the just and the unjust.

A slightly different form of this argument, and one the force of which is somewhat diminished since the extensive introduction of income taxes, is that an inheritance tax is but the payment of a tax which, in justice, should have been levied during the life of the decedent. It is simply a culmination of past property taxes, or income taxes, which were never levied, and which are now made payable at a more convenient time—when the individual has no more need for his accumulations.

The inheritance tax conforms, in large measure, to the principle of ability to pay. The payment of no other tax, perhaps, is so lightly felt. It is paid after the property has left the hands of the decedent and before it reaches those of the recipient. An inheritance is a sudden and often unexpected receipt of property. This additional property creates tax-paying ability, but never is the ability so great as before the property enters into the activities of the benefactor. In a few cases, of course, this increase in ability fails to materialize, as when a provident husband and father is taken from a wife and dependent children. Such situations are the exception, however, and can easily be cared for by the formulation of the law. The tax may be the source of much revenue with a minimum of sacrifice and with a small derangement of enterprise. In this respect it conforms to the modern utilitarian ideals of justice.

It is not surprising to find individuals who are looked upon as conservative, yet who are ardent enthusiasts for the adoption of the inheritance tax. With the constant growth in the functions of the state, the demands for revenue from the old sources have begun to cut deeply, and some relief from this previously little used source is looked upon with pleasure. The ease with which the burden is carried also makes a strong appeal. Many desirable state functions present themselves, yet the means of getting sufficient funds to carry them out is a pressing problem to which the inheritance tax is considered a partial solution. Many believe, further, that a proper use of the inheritance tax would cure much of the socialistic agitation against wealth, since most of the so-called unearned wealth arises through inheritances.

OBJECTIONS ARE WEAK

Most of the objections to the inheritance tax arise because of some of the reasons which have been advanced for its adoption, or because of some administrative difficulties, rather than to the tax itself. The use of the tax to penalize fortunes which have been amassed in an illegitimate or fraudulent manner is open at once to the objection that there is no way of differentiating the rate directly with the amount of evil connected with securing the estate. Rates have been made to vary with the size of the bequest, and with the degree of relationship, but neither of these is any indication of the manner by which the bequest originated. Many small accumulations of wealth involve a greater amount of dishonesty than many of the large accumulations, and to properly penalize them, the rates imposed would have to be regressive. This reasoning, however, can not be used as an objection to the inheritance tax, but only to its use for a particular purpose.

The objections that the inheritance tax will discourage savings, and can be easily evaded by gifts before death, have, in reality, little foundation. The discouragement of savings is a common objection to any tax. Few taxes, in fact, tend to discourage savings as little as a tax which does not

come until after death. To most individuals the event of death appears as a remote future occurrence, and a tax levied at such a time will have little influence on present accumulations of property. Such a tax may, on the other hand, be an added incentive to greater saving in some cases. To the provident husband and father, who wishes to leave a certain legacy to wife or children, the certainty of a tax deduction will necessitate the accumulation of a larger amount. Until a material change occurs in human nature, the evasion of the tax by a distribution of the property before death will be insignificant. Most men wish to retain title to their property while they are alive, and would rather the state secure a part of it at death than to give up the privilege of retaining it in their possession.

The objections that the tax falls with varying frequency upon different accumulations of wealth, and that it falls upon capital rather than upon income, are no more serious. It is no doubt true that transfers of property occur more frequently in some families than in others, and where the transfers are frequent, a greater percentage passes to the state than if the transfers are infrequent. The burden, however, is felt by a different individual with each levy of the tax—it is falling upon a newly created ability to bear tax burdens. Any hardship which might arise in the case of direct heirs can be alleviated by a system of exemptions, or by allowing a lapse of a certain number of years before a second tax will be placed upon the same property.

It is true that the burden of the tax may fall upon capital, and this condition sometimes exists. It frequently happens, also, that the tax is met from current income. Whatever may be the source of the tax, as long as the receipts go into the general fund, the demand for revenue from other sources is lessened to that extent. The amount paid in inheritance taxes does not have to be collected in property, income or other taxes. A larger amount of income can consequently be saved to replace or add to the existing amount of capital. Any tax will directly or indirectly fall upon the accumulation of capital, and the inheritance tax errs here to no greater extent than other forms of taxes.

Two quotations will indicate the esteem in which the inheritance tax is now held.

> Firmly entrenched in a long and honorable history, with the endorsement of leading economists of ancient and modern times, and approved by the present practice of most civilized governments, he would be indeed brave who should attempt to attack the theory or validity of any sane inheritance tax from an economic standpoint.[3]

Professor Underwood characterized the tax as follows: "A defense of the taxation of inheritances is superfluous. Its existence in all but a few civilized nations, and in all but a few of the more backward states, is its chief defense."[4]

ATTITUDE OF COURTS

Hundreds of cases involving different aspects of the inheritance tax have come before state and federal courts, and, with but few exceptions, the decisions have given this form of revenue a firmer place in fiscal systems. Nothing more will be attempted here than to mention a few of the more important aspects of the tax which have been established.[5]

[3] Blakemore and Bancroft, *Inheritance Taxes*, p. 9.

[4] J. H. Underwood, *State and Local Taxation*, Vol. 1, p. 211.

[5] Those who desire to go more extensively into this aspect of inheritance taxes will do well to consult the comprehensive work, *Inheritance Taxes*, by Blakemore and Bancroft, and a similar work, *Inheritance Taxation*, by P. V. Ross.

The constitutionality of the inheritance tax was formerly given much consideration. In regard to this aspect Ross writes:

> The constitutionality of the general principles of inheritance taxation has been affirmed by a multitude of decisions, so that the competency of Congress, or the legislatures of the several states, to impose an inheritance tax is universally conceded. The inherent justice and wholesomeness of this system of taxation have so appealed to the judicial mind that all the assaults that wealth, in its aversion to bear its just burdens, has conceived, have proved unavailing. The general doctrine that a state or the United States may raise revenue, and in bountiful quantities, by levying tribute upon estates in the course of transmission from decedents to their successors, is no longer doubted, and most of the attacks now made upon inheritance taxation are upon other than constitutional grounds.[6]

The use of the tax by the Federal Government has been sanctioned by the courts on the ground that it is an indirect or excise tax and therefore does not have to follow the rule of apportionment in the basis of population. It has been held, further, that the use of such a tax comes under the taxing power of the constitution and is not undertaken for the purpose of regulating the transmission of property. Since the powers of the state governments are residual, there is no restriction upon their use of the inheritance tax unless imposed by their own constitutions or statutes. The use of progressive rates has generally been held not to infringe upon the uniform tax clause which is found in many state constitutions.

The courts of nearly every state, those of Massachusetts and Wisconsin forming the principal exceptions, have held that the right of inheritance is not a natural right, but a privilege created by the state, and subject to such regulations as the state may see fit to impose. It has been frequently held that the tax is in the nature of an excise or franchise tax on the succession of the property, and not on the property itself. As one decision describes it,

> It is not a tax upon the property or money bequeathed, but a diminution of the amount that would otherwise pass under the will, and hence what the legatee really receives is not taxed at all. It is that which is left after the tax has been taken off. It is only imposed once, and that is before the legacy has reached the legatee, and before it has become his property.[7]

Some courts have held, however, that the tax is on the right to receive property rather than on the permission or right to transmit it. One decision says that, "Properly understood, it is not the right to transmit, but the right and privilege to receive, that is taxed—it is clear that the right is distinct and separate from the property itself, and the state may tax this right to receive property."[8]

This brief consideration of court decisions, while it indicates that judges have not always followed the same line of reasoning nor reached the same conclusions, shows how firm a legal footing the inheritance tax has attained. Litigation involving inheritance tax laws still arises at times, but it seldom has to do with constitutionality, or the power to impose such a tax. Many technicalities have arisen, but none of the decisions have vitiated the principles upon which the use of the tax is based. So far as any difficulties may have existed in the past from the legal viewpoint, these may now be considered as practically settled, and legislative bodies may feel free to make an extended use of the tax if they have not already done so.

[6] P. V. Ross, *Inheritance Taxation*, p. 20.

[7] *In re Finnen*, 196 Pa. St. 72.

[8] *State vs. Ferris*, 53, Ohio St. 314.

LEGISLATIVE PROBLEMS

While the principle of the inheritance tax may be considered just, and the conclusion be drawn that it unquestionably deserves a place in fiscal systems, this does not preclude the appearance of serious problems in its adoption and use. Some of the questions which immediately present themselves to the formulators of inheritance tax laws are such as the following: What shall be considered an inheritance for the purpose of taxation? What exemptions shall be allowed? What distinctions shall be made between near relatives, distant relatives and strangers? What rates shall be applied? What provisions shall be made to prevent evasions, or the tax becoming unduly harsh upon particular estates?

A determination of what shall be considered an inheritance raises the problem as to what should be deducted from the gross amount of the estate in order to have the proper base for the levy of the tax. All just obligations against the estate, for example, should be deducted. Other deductions, however, which are sometimes permitted, are not always so easily justified. Payments upon life insurance policies are usually not considered as part of the estate, yet the payment of insurance premiums is often looked upon primarily as an investment, with the payment at death as the return. This is true to a greater extent with the extremely large policies, and no good reason appears for allowing their deduction.

Closely connected with the problem of proper deductions, is the determination of the amount of exemption to be allowed, and the proper differentiations because of different degrees of relationship. The soundest approach to a solution is through an attempt to measure the relative abilities which the receipt of property creates. In the case of a small estate left to a widow or dependent child, there is evidently no increase in ability to meet burdens, and consequently no tax should be levied. In case the estate is large, however, a tax may be levied and no appreciable hardship will result. When an estate passes to distant relatives or strangers in blood, the income is much more of an accidental nature, and consequently less reason exists for allowing an exemption. The nature of the recipient has at times justly received consideration. For example, bequests to public, religious and charitable institutions have not been considered taxable.

The problem of determining the proper rate to be levied is important. Shall it be low or high, proportional or progressive, and to what degree should it vary for direct and collateral heirs? There has been absolutely no uniformity as to the size of the rate. In some countries the rate has been extremely high, in others it has been just as extreme in the opposite direction, while these same variations often exist in parts of the same country. The rate will be governed somewhat by the purpose which the tax is designed to accomplish. If it is intended to prevent the succession of large fortunes, the rate will doubtless be high. If, on the other hand, it is considered that the state should exercise little interference with property transfers, the rates will be low, as they will be, also, if it is feared high rates will cause evasion. There has been little question concerning the advisability of progressive rates, but much discussion has arisen over the steepness of the rate of progression, and how this should be affected by the degree of relationship. Those who would limit the transfer of wealth to a comparatively small amount would have the rate

steeply progressive to 100 per cent. Others would have it only moderately progressive on bequests to direct heirs, and steeply progressive on bequests to others. The general tendency has been to levy a low and slowly progressive rate upon bequests to near relatives, while the rate has been high and more steeply progressive upon other bequests.

It is important, where progressive rates are used, whether the base for the levy be considered the estate or the share. Suppose in an estate of $100,000, one individual is to receive $10,000, another $40,000, another $30,000, and another $20,000. If the tax were a proportional rate of 5 per cent, it would make no difference whether it were levied upon the entire estate or upon each individual share. If a progressive scale were in force, say, with an exemption of $10,000, 5 per cent on amounts between $10,000 and $50,000, 10 per cent on amounts between $50,000 and $100,000, the difference in tax burden between considering the entire estate and each share as the base of levy, becomes at once apparent. Only a few attempts have been made to use the size of the estate as the base, and these have either been refused by the courts or have been given up for other reasons. An exception is the inheritance tax used at present by the Federal Government, in which the estate is used as the base of the tax.

The gradual extension of the use of the inheritance tax, together with increased and more steeply progressive rates, has increased the likelihood of evasion, and has magnified any injustice which exists in the system. The temptation to dispose of property before death increases with the increase in rates. Cognizance has been taken of this situation, and "transfers of property in contemplation of death" have sometimes been made subject to the tax. The courts rather consistently held that, in such cases, the burden of proof rested with the state, the result of which was that few proofs were attempted. A more recent development has been legislation to the effect that all transfers of property within a certain period previous to death shall be considered as transferred in contemplation of death, and are therefore subject to the tax. In Wisconsin the period is six years. Recognition is sometimes made of the fact that some successions are likely to occur more frequently than others. If a son should die, for instance, and leave an estate to his father, it is likely a second bequest will follow much sooner than if the transfer had been in the opposite direction. Laws sometimes provide that a second tax will not be exacted if one has been paid within a certain number of years.

PROBLEMS FROM CONFLICTING JURISDICTIONS

The existence of a number of political units, the interests of which are not separate and distinct, and the attempt of each of these units to adopt a system of taxation designed for its own needs with little consideration for those of its political neighbors, has caused many serious problems for those seeking to secure justice in taxation. This situation has enhanced the problem of securing just inheritance taxation, particularly in the United States with its many political divisions. A few of the states do not use the tax, while in the others it varies from a half-hearted attempt to secure a little revenue from collateral heirs, to highly progressive rates upon all estates. The laws lack uniformity not only in respect to rates and progressions, but also in the bases upon which the tax is levied. The result is that some estates are subject to more

than one tax, while others escape the tax they are really expected to pay.

The domicile of the decedent has been used, to a large extent, as the base for levying inheritance taxes. Since the burden varies to such an extent in the various states, it becomes profitable, especially in the case of large estates, to change the place of residence—although the business, property and economic interests are not changed—to a state with lenient considerations toward bequests. Because of the adoption of the income tax by some states, the selection of a suitable domicile assumes a rôle of still greater importance. A state that is lenient in the matter of income taxes, as well as in the levy of inheritance taxes, is bidding to become a popular place of residence for men of wealth. This is particularly true of the eastern states, where the states are small and where there are large accumulations of wealth. The possibility of change of residence has no doubt had an influence in keeping a number of states from making a greater use of inheritance taxes. They have feared to increase the severity of the burden beyond that of neighboring states, lest the wealthy citizens change their domicile.

Many states levy the inheritance tax upon the basis of situs of the real estate and upon the personal property of individuals living within the state. Some states go further and impose the tax upon the shares of stock of a domestic corporation, while some go still further and levy the tax upon such shares of stock, although owned by a non-resident of the state. Some states even tax shares of stock and bonds at their physical location, for example, shares of stock or bonds deposited in a bank for safekeeping, no matter where the residence of the owner. Indebtedness has also been used as a base for the levy—that is, bonds would be taxed in the state from which issued no matter where the owner lived or died.

The complexity that arises from these diverse methods of levying the tax by more or less competing jurisdictions can easily be imagined. Two, three, four, and even more taxes may be collected from one estate, the injustice of which is at once evident. Suppose an individual dies in state *A*, who was a citizen of state *B*, and who owned $100,000 in bonds of a corporation chartered in state *C*, the actual property of which was located in state *D*, while the bonds were in a safety box in state *E*. The inheritance tax laws of state *A* taxes the property of every decedent of the state; *B*, that of every citizen; *C*, the bonds of corporations chartered within the state; *D*, the property where located, while *E* taxes the securities at their situs. Under these conditions the bonds would bear the tax rate in force in each of the states. A case as extreme as this would, of course, seldom occur, yet examples of double and triple taxes upon one estate may easily be found.

The chaotic condition of our inheritance tax laws is far from satisfactory. The expense and delay in settling estates is often increased many-fold, while the decisions of the courts have become so numerous and so hair-splitting as to add greatly to the complexity of the situation. The instability of legislation in the different states, moreover, is not conducive to the comfort of investors. Nineteen states modified their inheritance tax laws in 1919. The law in the state of New York has been amended more than forty times. One never knows what may be the condition a few years hence. While no single state may impose an excessive burden upon

estates, yet the piling up of double and multiple taxation may develop an excessive burden which may even necessitate a dismemberment of the property in order to be able to pay the tax.

As much as it is desired to better the situation, a remedy seems far to seek. Some uniform system which would eliminate double taxation would be the logical solution. To secure coöperation among the states, each with its own selfish interests paramount, to the end of a uniform method of inheritance taxation is too much to hope for. The recent reëntrance of the federal government into this field of revenue, however, presents a possible solution, yet doubtless a very improbable one. Uniformity could be secured by the individual states giving up their diversified systems, and allowing the federal government to occupy the field with a uniform law. The machinery for the transfer of property, located in the states, would necessarily continue to be used, and a part of the revenue collected could be distributed back to the states. Rates, under this arrangement, could be made high enough to make the inheritance tax a powerful source of revenue. To secure the consent of the states to any such arrangement would be practically impossible, while the finding of some practical basis upon which to distribute a part of the amount collected back to the states presents a problem of some difficulty.

In spite of the difficulties, however, the inheritance tax is destined to play a rôle of much greater importance in the fiscal systems of our states, and probably in that of the federal government, than it ever has in the past. Its outstanding advantages can not but be recognized. The opportunity for fraud and evasion is minimized since the machinery of the courts must be used in making transfers of property. The receipts come in throughout the year with comparatively few payments compared with the amount of revenue received. For large political units, moreover, the yield is remarkably uniform. It is a tax well suited to provide an elastic feature to a fiscal system—a rise in the rate will not cut off the source of the tax by causing fewer deaths, although a greater amount of evasion may be practiced. The incidence, moreover, is certain—a definite amount is taken from the estate before it reaches the recipient, the burden falls upon him, and he can not shift it. It is a tax in close conformity to Adam Smith's four canons of taxation: it falls according to ability, is certain, is paid at the time most convenient, and should be an inexpensive tax to collect.

USE BY THE FEDERAL GOVERNMENT

The inheritance tax has found a place in the fiscal system of the federal government at several different times. Generally, this has been in times of emergency when the primary object was to secure more revenue. As early as 1794 recommendations were made for a tax upon the devolution of property at death. The first law which instituted a tax of this nature was passed in 1797 and remained in force until 1802. Direct heirs were exempt from the tax, while others were taxed only upon the excess above $50. The rate was 25 cents when the amount was not more than $100; from $100 to $500 it was 50 cents; the tax on $500 was $1, and an additional dollar was added for each increase of $500. This levy resembled a fee payment and was regressive within each grade, yet in this early levy upon the succession of property at death we find recognition of the principles of progressive rates and a differentiation on the basis of relationship.

After the repeal of this law other recommendations for the federal taxation of inheritances were made, but Congress enacted no similar legislation until 1862. The levy of 1862 was of two kinds, one known as a legacy tax and the other as a succession tax. The rates were progressive, ranging from 1 per cent to 6 per cent, and provision was made for an exemption of $1,000. The law was repealed in 1870, the revenue having increased from about $500,000 the first year of use to nearly $3,000,000 the last year. This last amount represented a little less than 2 per cent of the total internal revenue receipts.

Taxes upon inheritances and gifts were included in the ill-fated income tax law of 1894. In 1898, however, they were again introduced to help meet the emergency need for revenue. This law, which was repealed in 1902, differentiated between degrees of relationship, and used progressive rates which went as high as 15 per cent upon transfers to collateral heirs. The revenue received was not inconsiderable; in 1902–1903 more than 2 per cent of the internal revenues came from this source.

The inheritance tax was again called into use to help meet the emergency revenue needs caused by the Great War. The United States, in reality, began her provision for war revenue before a state of war actually existed. The revenue act of 1916 was largely a preparedness measure, as was also in some respects the revenue act of 1914. The inheritance tax was introduced in the 1916 revenue act. The tax was imposed upon the entire net estate of all citizens, whether resident or non-resident. The tax was upon the estate and not upon each share of the estate. Certain deductions were allowed, as was also an exemption of $50,000. The rates, which applied alike to direct and collateral inheritances, were progressive and ranged from 1 per cent on a net estate up to $50,000 to 10 per cent on all over $5,000,000. This schedule of rates was increased to range from 1½ per cent to 15 per cent before the law of October, 1917—the one real war revenue act. By the law of 1917, additional rates were placed upon the same grades from one-half of one per cent on the lowest to 10 per cent on the highest—all bequests of more than $10,000,000. Under this act, therefore, the maximum inheritance tax which could be collected was 25 per cent. Modifications were again made by the revenue act which was adopted in February, 1919. Some attempts were made to place the tax upon each share rather than upon the net estate, but the change was not made. The rates in the lower grades were somewhat reduced, and under this law, after deductions and exemptions are allowed, the schedule of rates payable to the federal government is as follows:

RATES PAYABLE TO FEDERAL GOVERNMENT

Per cent	*On Amount of Net Estate*		
1	not in excess of $50,000		
2	between	$50,000 and	$150,000
3	"	150,000 and	250,000
4	"	250,000 and	450,000
6	"	450,000 and	750,000
8	"	750,000 and	1,000,000
10	"	1,000,000 and	1,500,000
12	"	1,500,000 and	2,000,000
14	"	2,000,000 and	3,000,000
16	"	3,000,000 and	4,000,000
18	"	4,000,000 and	5,000,000
20	"	5,000,000 and	8,000,000
22	"	8,000,000 and	10,000,000
25	above	10,000,000	

There has been much disagreement as to the use the Federal Government should make of the inheritance tax. Many authorities hold that this field of revenue should be left entirely to the

use of the states, the expenditures of which are continually on the increase. This contention was partially responsible for the reduction of rates in the above schedule from those of the previous legislation. On the other hand, however, the needs of the Federal Government have increased greatly, and these needs must be met from revenue. The larger the amount that is collected from inheritance taxes, the less will remain to be collected from other sources, perhaps more burdensome. There is no good reason why both the Federal Government and the state governments should not use this source of revenue, nor why they should not coöperate in making the tax uniform and just.

USE BY STATE GOVERNMENTS

Ever since Pennsylvania adopted the principle of the inheritance tax, in 1826, it has been found embodied in the fiscal system of one or more of the American states. Its importance has greatly increased, however, in the last quarter century, and, in 1920, forty-five of the forty-eight states were using some form of the tax. As the needs for revenue continue to become more pressing, as the legislators become educated to the merits of the tax, and as more coöperation can be developed among the different states, a much more thorough use of this form of taxation can be expected as a source of state revenues.

The inheritance tax laws in our states have taken nearly every conceivable form. The early Pennsylvania tax was $2\frac{1}{2}$ per cent levied upon the transfer of property to collateral heirs. An exemption of $250 was allowed. Two years later Louisiana placed a tax on property going to foreign heirs. Gradually other states were added to the list, and, as the years went by, amendment was placed upon amendment, the courts became more favorable, until the present diverse and non-uniform systems of the different states resulted. Even if space permitted, little would be gained by giving the method by which each state levies a tax upon inheritances. Changes are imminent in many of the laws, so that a survey which could be given of present methods would doubtless be far from correct in the not distant future.

It is worth while to note what has been done in one or two instances. The State of New York is considered to have one of the best inheritance tax laws. An exemption of $5,000 is allowed to direct heirs, and $1,000 to collateral heirs. The rates are as follows:

	DIRECT *per cent*	COLLATERAL *per cent*
Above exemption, up to $50,000	1	5
From $50,000 up to $250,000	2	6
From $250,000 up to $1,000,000	3	7
All above $1,000,000	4	8

The law also seeks to avoid double and multiple taxation such as was described above. The estates of residents are taxed upon tangible property within the state, and intangible property wherever it may be situated. No tax is placed upon the intangible property in the estates of non-residents, and only the tangible property within the state is taxed. The intangible property includes such items as money, bank deposits, shares of stock, bonds, notes and similar items. Bequests to religious, educational and charitable institutions, whether within or without the state, are exempt from the tax.

Many other states have modified their laws and the attempt to conform more nearly to the principles of justice

has not always been absent. The influence of the unselfish legislation of such a progressive state as New York has doubtless been felt. California was one of the first states to follow the example set by New York, yet went much further in the steepness of rates. The rate on bequests to direct heirs is progressive from 1 to 5 per cent, while on those to collateral heirs it ranges from 2 to 25 per cent. There is still evidence in some states of the tendency to introduce the tax by first placing it upon transfers to collateral heirs and then gradually extending it to include transfers to direct heirs. A few years ago many states used a collateral inheritance tax with no tax upon transfers to direct heirs, and this condition still remains in a few cases. Gradually, however, the scope of the laws has been extended to include direct bequests, although with higher exemptions and lower rates, until it is likely that the time is not far distant when direct inheritance taxes will be used in all the states where a tax upon collateral transfers is now used.

The abundance of revenue from other sources has made the American states somewhat slow in seizing upon the inheritance tax as a part of their fiscal systems. The tax is one, however, that appeals to public sentiment, and without doubt has come to stay. In the future it will be found to occupy a place of increasing importance in our sources of revenue.

USE BY FOREIGN GOVERNMENTS

Nothing more can be done than to indicate that the inheritance tax has been used extensively abroad. An extended study would reveal how dilatory America has been in seizing upon this principle. The tax has been extensively used in Switzerland, Spain, Sweden, Holland, Italy, Germany, Greece, France, Russia, England, Ireland, Canada, Australia, Belgium, Portugal, Austria and many other countries. Highly progressive rates are found in many of these countries, particularly in France, England, Australia and Switzerland. Outside of the United States, the tax seems to have had its broadest development in the more democratic countries.

England has used the principle since 1780. Amendments have been made until the tax takes three forms; one on the general estate, one on the personal property and one on real estate. The estates are graduated and taxed at a progressive rate ranging from 1 per cent to 23 per cent. In France, the maximum rate imposed upon collateral inheritances is over 20 per cent, while the maximum rate upon direct transfers is about 5 per cent. In Italy and Germany the rates have been somewhat higher. The Australasian and Canadian provinces have followed the lead of the mother country, and are making extensive use of the tax with steeply progressive rates.

SUMMARY

The principle of levying some form of a tax upon the transfer of property at death is not new. Traces of the use of the principle may be found among the earliest records. Its importance was not overlooked by the early writers upon fiscal subjects, but much discussion may be found both for and against the use of inheritance taxes. The broadening of the functions of governments, with the accompanying demands for increased revenues, has caused more prominence to be attached to the use of taxing inheritances in recent years. Many theories have been advanced to justify the tax, ranging all the way from those with purely social motives to those which champion it because it falls most nearly in accordance with ability

to bear tax burdens. Some objections have been raised to the use of the principle, but most of them are weak and apply to some of the purposes for which it has been proposed rather than to the tax itself. Much litigation has arisen over its use, but the court decisions have generally strengthened the position of the principle as a part of fiscal systems.

In the use of the tax, many problems have arisen, particularly in the formulation of just laws, and in the double and multiple taxes which have been placed upon single estates because of conflicting jurisdictions. The tax has been used by the Federal Government at different times as an emergency measure, and may be continued as a part of its fiscal machinery. The states have used it more or less since 1826 but it is only in recent years that much importance has been attached to the fiscal possibilities. Foreign countries have developed comprehensive systems of inheritance taxes.

Since inheritance taxes so admirably supplement income taxes, and since each has become so deservedly popular among fiscal authorities and officials, it is not too much to expect that each will hold a place of vital importance in future revenue systems, not only of federal governments, but also of the provinces and states. Because of its backwardness in the past, the United States may be looked upon to furnish examples of the most rapid extension of the use of inheritance taxes during the next few decades.

The Net Income and Excess Profits Should Be Kept as the Main Sources of National Taxation

By H. C. McKENZIE

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TIME was when the average citizen gave mighty little attention to the methods of raising the revenue necessary to run the government: almost all the revenue necessary was raised by the tariff and a tax on booze. Some time ago a great cry was raised because Congress spent a billion dollars in *two* years. It was called "The Billion Dollar Congress." It is a far cry from that time and an annual budget of $500,000,000 to the fiscal year 1921 and a budget of $5,600,000,000.

During the last six months there has been a determined effort to work up public sentiment in favor of changing some of the important features of our present tax laws, notably in favor of lowering the higher brackets of the surtaxes on individuals and in favor of the repeal of the excess profits tax on corporations. Part of this agitation has been an honest effort to determine how the necessary revenue should be raised, but a great deal of it has been propaganda put out by those who are now carrying a heavy tax burden, and who most earnestly desire to shift the burden to other shoulders. The papers and magazines have been full of statements that the taxes are ruining business, that the excess profits tax must be repealed, and that the system must be revised, and generally without any clear statement of what is to take the place of the abolished schedule.